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IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF ARIZONA

Verve, L.L.C.,

Plaintiff,

vs.

Hypercom Corp.,

Defendant.

Hypercom Corp.

Counter-Claimant,

vs.

Verve, L.L.C., Raymond M. Galasso,  
Kevin R. Imes, Simon, Galasso & Frantz)  
P.L.C.

Counter-Defendants.

No. CV-05-0365-PHX-FJM

**ORDER**

The court has before it Hypercom Corporation's ("Hypercom") motion for summary judgment (doc. 243), Verve, L.L.C.'s ("Verve") response (doc. 260), and Hypercom's reply (doc. 274); Verve's motion for summary judgment (doc. 240), Hypercom's response (doc.

261), and Verve's reply (doc. 273).<sup>1</sup> We also have before us Gabroy, Rollman & Bossé, P.C.'s motion to withdraw (doc. 275) and Hypercom's response (doc. 278).

### **I. Background**

Hypercom alleges that Verve, Raymond Galasso, Kevin Imes and the law firm of Simon, Galasso & Frantz P.L.C. ("SGF Firm") (collectively "counter-defendants") engaged in a harassment campaign against Hypercom and others by instituting costly, inconvenient, and groundless patent infringement lawsuits for the sole purpose of extorting "settlements" of these claims. Verve contends that it is a patent holding company that acquires patent rights in order to generate revenue from those patents, either through licensing agreements or infringement litigation. Omron Corporation ("Omron") purported to assign several of its patents to Verve in exchange for a percentage of the revenue generated by Verve. Raymond Galasso is the founder and 50% owner of Verve, and is the head of the intellectual property practice at the SGF Firm. Kevin Imes is a patent agent, registered to practice before the U.S. Patent and Trademark Office, and a 50% owner of Verve.

In order to evaluate the cross-motions for summary judgment, we first examine the parties' extensive litigation history. On September 11, 2003, Verve filed an action in the Eastern District of Michigan against Hypercom and other unrelated companies, alleging infringement of U.S. Patent No. 4,678,895 ("895 patent") (the "Michigan action"). In June 2004, one month after Hypercom succeeded in severing and transferring the Michigan action to the District of Arizona, Verve voluntarily dismissed the action.

On February 4, 2004, Verve filed a second patent infringement complaint against Hypercom and seven other companies in the Western District of Texas, alleging infringement of U.S. Patent No. 4,562,341 ("341 patent"). On December 29, 2004, the Texas action was

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<sup>1</sup>Verve submits each of its pleadings in its name only, notwithstanding the fact that Hypercom seeks summary judgment against all counter-defendants. Nevertheless, arguments on behalf of individual counter-defendants are set forth throughout Verve's documents. Therefore, we construe Verve's pleadings as submitted on behalf of each counter-defendant.

1 transferred to this court and is the case presently before us.<sup>2</sup> Hypercom filed its  
2 counterclaims on November 16, 2005, against Verve, Galasso, Imes and the SGF Firm,  
3 alleging (1) malicious prosecution, (2) abuse of process, and (3) violation of 28 U.S.C. §  
4 1927. On December 13, 2005, Verve's claims against Hypercom were dismissed when Verve  
5 failed to comply with our order to retain counsel (doc. 172). All that remains in this case are  
6 Hypercom's counterclaims.

7 Verve next filed a complaint with the International Trade Commission ("ITC") in  
8 Washington, D.C., on August 2, 2004, alleging that Hypercom and others had infringed U.S.  
9 Patent No. 5,012,077 ("077 patent") ("ITC action"). The ALJ determined that Verve did not  
10 have standing to independently assert patent rights; concluded that Verve's actions amounted  
11 to bad faith and abuse of process; and issued an order imposing sanctions in the amount of  
12 \$1,000,000 against Verve, Galasso, Imes and the SGF Firm payable to the United States  
13 Treasury. The Commission reviewed the sanctions order on appeal and concluded that the  
14 ALJ had improperly applied a bad faith, rather than an objectively unreasonable standard,  
15 and remanded the case to the ALJ for application of the appropriate standard. That action  
16 remains pending.

17 On August 30, 2004, Verve filed another complaint against Hypercom and others in  
18 the Northern District of California ("California action"), again alleging infringement of the  
19 077 patent. After Hypercom threatened to seek Rule 11 sanctions against Verve, Verve  
20 dismissed the complaint.

## 21 **II. Federal Preemption**

22 Verve first contends that Hypercom's state law claims are preempted by federal law.  
23 It asserts that by virtue of 35 U.S.C. § 285, which provides that a "court in exceptional cases  
24 may award reasonable attorney fees to the prevailing party" in patent cases, Congress has  
25 occupied the field, and accordingly state law claims for malicious prosecution and abuse of  
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27 <sup>2</sup>Both the Texas and Arizona phases of this action are referred to herein as "the Texas  
28 action."

process are preempted. This argument is without merit. In U.S. Aluminum Corp. v. Alumax, Inc., 831 F.2d 878, 881 (9th Cir. 1987), the court stated that "[w]hile we do not deny that conflict is possible between state malicious prosecutions laws and federal patent laws, the policies underlying each are not inherently antithetical. Patents do not create an exemption from state malicious prosecutions laws." Id. (citing Handgards, Inc. v. Ethicon, Inc., 601 F.2d 986, 998 n.17 (9th Cir. 1979)). See also Hydranautics v. FilmTec Corp., 204 F.3d 880, 886 (9th Cir. 2000) (approving a state law malicious prosecution claim arising from patent infringement action). Federal law does not preempt Hypercom's state law claims.

### III. Hypercom's State Law Claims

#### A. Malicious Prosecution

Under Arizona law, a malicious prosecution claim exists where a defendant "(1) instituted a civil action which was (2) motivated by malice, (3) begun without probable cause, (4) terminated in plaintiff's favor and (5) damaged plaintiff." Bradshaw v. State Farm Mut. Auto. Ins. Co., 157 Ariz. 411, 417, 758 P.2d 1313, 1319 (1988). Hypercom's malicious prosecution claim is based on Verve's allegedly tortious conduct in filing patent infringement lawsuits in Michigan, Texas, California, and the ITC.

Hypercom contends that counter-defendants conducted virtually no pre-filing investigation prior to filing the infringement claims and therefore the actions were instituted without probable cause. The existence of probable cause is measured by the objective standard of Rule 11, Fed. R. Civ. P. See Wolfinger v. Cheche, 206 Ariz. 504, 509-10, 80 P.3d 783, 788-89 (Ct. App. 2003). Under Rule 11, a lawyer "must possess a good faith belief, formed on the basis of a reasonable investigation, that a colorable claim or defense exists." Id. at 510, 80 P.3d at 789. In the patent litigation context, probable cause requires a reasonable pre-filing investigation of the accused product in comparison to the patent claims. See e.g., Judin v. United States, 110 F.3d 780, 784 (Fed. Cir. 1997) (finding a Rule 11 violation where neither patentee nor his attorney compared the accused devices with the patent claims or otherwise made a reasonable inquiry to determine that the complaint was well grounded in law and fact). "In bringing a claim of infringement, the patent holder, if

1 challenged, must be prepared to demonstrate to the court . . . exactly why it believed before  
2 filing the claim that it had a reasonable chance of proving infringement. Failure to do so  
3 . . . should ordinarily result in . . . sanctions." View Eng'g, Inc. v. Robotic Vision Sys., Inc.,  
4 208 F.3d 981, 986 (Fed. Cir. 2000) (imposing Rule 11 sanctions where patent holder  
5 performed no independent claim construction or written infringement analysis).

6 Hypercom relies on the testimony of its expert, Laurence Pretty, who concluded, in  
7 part, that (1) counter-defendants filed each action without a reasonable pre-filing  
8 investigation; (2) there was no infringement of any of the patents; (3) counter-defendants  
9 improperly prolonged the ITC action after Hypercom conclusively established that its  
10 terminals did not infringe the 077 patent; (4) Verve lacked probable cause to file the actions  
11 in its own name when Omron retained substantial rights to the patents; (5) Verve's service  
12 of a complaint for infringement of the 341 patent three months after the patent had expired  
13 demonstrated an improper purpose in bringing the action; and (6) Verve's overall actions in  
14 filing multiple lawsuits, in multiple jurisdictions against Hypercom, without any reasonable  
15 explanation, demonstrated an improper purpose.

16 Hypercom also contends that lack of probable cause is evidenced by the ALJ's  
17 conclusion in the ITC action that "Verve's filing of the complaint in the face of virtually no  
18 pre-filing investigation of Hypercom's accused products demonstrates an abuse of process  
19 and bad faith." ALJ Order No. 48 at 17. Because Verve asserted the same allegations in the  
20 California Action only weeks later, and counter-defendants fail to show any interim  
21 investigation, Hypercom contends that the ALJ's finding of lack of probable cause applies  
22 equally to the California Action.<sup>3</sup>

23 Hypercom further asserts that the lack of probable cause, bad faith, and malice is  
24 evidenced by counter-defendants' intentional misrepresentation of the relationship between  
25 Verve and Omron during the ITC action. Verve represented that it was "the owner" of the

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27 <sup>3</sup>Although the Commission subsequently remanded the ITC action to the ALJ, it left  
28 undisturbed the ALJ's findings related to the lack of pre-filing investigation, abuse of  
process, and bad faith.

1 077 patent, notwithstanding that the Omron-Verve assignment agreement left Omron with  
2 substantial rights in the patents, thereby depriving Verve of standing to sue. Pretty Report  
3 at 23-24. Hypercom alleges that counter-defendants affirmatively concealed from  
4 Hypercom, the ITC, and its own counsel, Dewey Ballantine, L.L.C., the existence of an April  
5 2004 addendum to the assignment agreement, which revealed that Verve lacked standing to  
6 bring the ITC action. Only after Verve and Dewey Ballantine verified in interrogatories that  
7 "Omron did not retain any right, title or interest in the '077 patent," did Verve finally disclose  
8 the April 2004 addendum to Dewey Ballantine. Shortly thereafter, Dewey Ballantine  
9 withdrew from representation of Verve.<sup>4</sup> HSOF ¶¶ 69-72.

10 In opposition to Hypercom's motion for summary judgment on the malicious  
11 prosecution claim, Verve only discusses its alleged pre-filing investigation of the ITC action.  
12 It fails to discuss what evidence, if any, established that it performed a pre-filing  
13 investigation of the Michigan, Texas or California actions. Verve Response at 4-7.<sup>5</sup> With  
14 respect to the ITC action, Verve relies solely on the testimony of Kevin Imes and SGF  
15 attorney Christopher Walton. In his declaration, Walton broadly stated that he reviewed the  
16 language of the 077 claims and the "product specification literature for each of the accused  
17 products," and "conducted an infringement analysis." VSOE, Ex. E ¶¶ 3, 6. Walton's  
18 declaration, however, fails to identify what literature he reviewed or how this review led to  
19 the infringement determination. He simply states that he reviewed unspecified literature and  
20 made a comparison. This type of vague, conclusory testimony is insufficient to raise a  
21 genuine issue of fact regarding probable cause.

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24 <sup>4</sup>Notwithstanding these rather suspect facts, the ALJ declined to sanction counter-  
25 defendants based on Verve's erroneous assertions that it was the "owner" of the patents and  
26 had standing to assert the claims. ALJ Order No. 40 at 22.

27 <sup>5</sup>This is a separate and independent reason to accept as true Hypercom's assertion that  
28 counter-defendants failed to perform a pre-filing investigation of these claims and therefore  
lacked probable cause. See LRCiv 7.2(i), and Rule 56(e), Fed. R. Civ. P.

1 Imes testified that he read the claims and specifications of the 077 patent, but he only  
2 compared those specifications to products of another company, not Hypercom. VSOE, Ex.  
3 C at 131-40, 150-52. Imes also refers to "testing" he conducted between May and July of  
4 2004, which consisted of "observing" terminals, including Hypercom models. VSOE, Ex.  
5 D at 58-61. But there is no indication whether these models were the accused products in the  
6 infringement actions; Imes has no record of this testing; and there is no information  
7 whatsoever regarding the test results.

8 A further review of the record reveals that Imes never obtained a sample of any  
9 Hypercom product and he was unsure whether he used or observed the use of any Hypercom  
10 product before the Michigan Action was filed. HSOE, Ex. E at 36-39, 58. Although he and  
11 the SGF Firm were "primarily" responsible for the investigation, HSOE, Ex. D at 28-29, he  
12 testified that he did not know what investigation or information formed the basis for filing  
13 the Michigan lawsuit. HSOE, Ex. E at 38, 58-60. Moreover, he had no knowledge of anyone  
14 preparing a comparison of any accused Hypercom product to the 341 patent before the Texas  
15 action was filed, beyond asserting that a comparison "would have been done." Id. at 73-75.  
16 Although Imes testified that he believed that written comparisons were made and that the  
17 SGF Firm would have copies of them, id. at 73-74, no such documents were produced. In  
18 fact, counter-defendants failed to produce any written documentation of any infringement  
19 study conducted prior to filing any of the Hypercom infringement actions. The record is  
20 simply devoid of any evidence supporting Verve's claim that an adequate pre-filing  
21 investigation was conducted in any action.

22 We reject counter-defendants' argument that they acted on the advice of counsel  
23 before instituting legal action and therefore probable cause is established as a matter of law.  
24 The only outside counsel involved in any action denied that it conducted any pre-filing  
25 investigation into any matter. HSOE, Ex. G at 2. Furthermore, counter-defendants cannot  
26 simply rely on the representation by the SGF Firm, which is itself a counter-defendant  
27 alleged to have maliciously prosecuted these claims.  
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1 Based on the undisputed facts, we conclude that counter-defendants fail to raise an  
2 issue of material fact on whether probable cause existed to support the filing of the Michigan,  
3 Texas, California and ITC actions.

4 As to the remaining elements of the malicious prosecution claim, there is no dispute  
5 that civil actions were instituted and that they caused damage to Hypercom. Galasso, Imes  
6 and the SGF Firm, as instigators of the litigation, can be held liable even if the actions were  
7 not filed in their names. See Bradshaw, 157 Ariz. at 417, 758 P.2d at 1319.

8 The element of malice can be proven by showing that the plaintiff filed the action for  
9 an improper purpose, such as "forc[ing] a settlement upon an unwilling opponent." Id. at  
10 418-19, 758 P.2d at 1320-21. Here, malice is established by the counter-defendants' wholly  
11 insufficient pre-filing investigation of the infringement claims; representing Verve as the  
12 proper patent owner knowing Omron held substantial rights in the patents; continuing to  
13 pursue claims in various jurisdictions once it was established that it lacked standing; and the  
14 tactic of filing multiple lawsuits in multiple jurisdictions without a reasonable explanation  
15 for doing so.

16 Finally, with respect to the element of favorable termination, because the ITC action  
17 and this court's December 13, 2005 order (doc. 172) are on appeal, there has been no final  
18 judgment in favor of Hypercom, and these actions cannot yet form the basis of a malicious  
19 prosecution claim. See Frey v. Stoneman, 150 Ariz. 106, 109-10, 722 P.2d 274, 277-78  
20 (1986) (stating that "if an appeal is pending, a malicious prosecution action is premature).

21 Therefore, based on the foregoing, we grant in part Hypercom's motion for summary  
22 judgment on the malicious prosecution claim as to the Michigan and California actions and  
23 deny the motion as to the ITC and Texas actions. Conversely, we deny Verve's motion  
24 regarding the Michigan and California actions, and grant the motion as to the ITC and Texas  
25 actions without prejudice to Hypercom's right to reassert the claims in another action in the  
26 event of favorable determinations on appeal.



## B. Abuse of Process

Abuse of process is established by showing that "the defendant has (1) used a legal process against the plaintiff; (2) primarily to accomplish a purpose for which the process was not designed; and, (3) harm has been caused to the plaintiff by such misuse of process." Nienstedt v. Wetzel, 133 Ariz. 348, 353, 651 P.2d 876, 881 (Ct. App. 1982). Counter-defendant's only argument in opposition to Hypercom's motion for summary judgment is that an administrative proceeding before the ITC cannot serve as a basis for an abuse of process claim. Verve's Response at 13-14. "Process" is broadly defined as "encompassing the entire range of court procedures incident to the litigation process." Nienstedt, 133 Ariz. at 353, 651 P.2d at 881. Therefore, while "process" is broadly defined, it is nevertheless limited to "court procedures." Id.; accord Competitive Techs. v. Fijitsu Ltd., 286 F. Supp. 2d 1118, 1155 (N.D. Cal. 2003) (holding that the "process that is alleged to have been abused must be a judicial process, and courts have rejected claims based on administrative proceedings"). Accordingly, we conclude that counter-defendants' actions related to the ITC administrative proceedings cannot form the basis of an abuse of process claim.

Because counter-defendants do not otherwise challenge the abuse of process claim, and based on our previous rulings, we conclude that counter-defendants's litigation scheme amounted to an abuse of process and accordingly grant Hypercom's motion for summary judgment with respect to the Michigan, Texas,<sup>6</sup> and California actions, but deny the motion as to the ITC action.

## IV. Joint Liability

Hypercom relies on a conspiracy theory to support its state law claims against each of the counter-defendants. Although there is no civil action for conspiracy, "there is an action for damages caused by acts committed pursuant to a conspiracy." Estate of Hernandez

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<sup>6</sup>We note that, unlike the tort of malicious prosecution, termination of the action in the claimant's favor is not a requisite element of an abuse of process claim.

1 v. Flavio, 187 Ariz. 506, 510, 930 P.2d 1309, 1313 (1997). The purpose of a civil conspiracy  
 2 is not to impose additional liability, but to identify joint tortfeasors. See Pankratz v. Willis,  
 3 155 Ariz. 8, 12, 744 P.2d 1182, 1186 (Ct. App. 1987). "When a civil wrong occurs as the  
 4 result of concerted action, the participants in the common plan are equally liable."  
 5 McElhanon, Jr. v. Hing, 151 Ariz. 386, 392, 728 P.2d 256, 262 (Ct. App. 1985).

6 Here, Imes identified litigation targets, verified complaints, and, along with the SGF  
 7 Firm, was "primarily" responsible for conducting the pre-filing investigation. Galasso signed  
 8 the complaint and entered an appearance as counsel for Verve in the Michigan action. He  
 9 was manager of Verve, the head of the intellectual property practice at the SGF Firm, and  
 10 had control over the several SGF lawyers assigned to work on the cases.

11 Verve argues that a conspiracy claim cannot stand because Galasso and Imes were  
 12 working as agents for Verve and an entity cannot conspire with itself. However, the  
 13 undisputed evidence shows that Verve, Galasso, Imes, and the SGF Firm also worked in  
 14 concert with Omron in furtherance of the litigation harassment scheme. Pursuant to a written  
 15 agreement, Omron assigned patent rights to Verve and was entitled to receive a substantial  
 16 percentage of the revenue resulting from the litigation. HSSOF ¶ 4. Omron was aware of  
 17 and consented to the counter-defendants' plan to sue Hypercom. Id. ¶ 5. Omron employees  
 18 and attorneys provided substantial assistance in preparation for the ITC proceeding, including  
 19 traveling to Japan to prepare a potential witness, and contacting a Japanese lawyer to provide  
 20 assistance to Verve. Id. ¶¶ 16-23. Omron insisted that Verve be the named party in the  
 21 infringement lawsuits so that Omron would have "zero risk." Id. at 24. This is clear and  
 22 convincing evidence of an agreement between counter-defendants and Omron.<sup>7</sup> Wells Fargo  
 23 Bank v. Arizona Laborers, Teamsters & Cement Masons, 201 Ariz. 474, 499, 38 P.3d 12, 37  
 24 (2002) (stating that claim for civil conspiracy must include an actual agreement, proven by  
 25 clear and convincing evidence). The uncontroverted evidence establishes that each counter-

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 27 <sup>7</sup>We do not consider Verve's argument, raised for the first time in its reply, that  
 28 Galasso and Imes are not proper counter-defendants without first piercing the corporate veil.

1 defendant participated in the underlying scheme, rendering each a joint tortfeasor liable for  
2 damages resulting from both the malicious prosecution and the abuse of process claims.

3 **V. 28 U.S.C. § 1927**

4 As an alternative theory of recovery, Hypercom alleges in count III that the counter-  
5 defendants violated 28 U.S.C. § 1927, which provides that "[a]ny attorney or other person  
6 admitted to conduct cases in any court of the United States . . . who so multiplies the  
7 proceedings in any case unreasonably and vexatiously may be required by the court to satisfy  
8 personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such  
9 conduct." We have previously dismissed Verve from this claim because it is not an "attorney  
10 or other person admitted to conduct cases in any court." (doc. 172). For the same reason,  
11 we also conclude that Imes is not subject to § 1927 liability.

12 Counter-defendants now argue that Galasso and the SGF Firm should also be  
13 dismissed from this claim. The SGF Firm is not, strictly speaking, an "attorney or otherwise  
14 admitted to conduct cases." Although there may be other avenues of authority to sanction  
15 a law firm, see Lockary v. Kayfetz, 974 F.2d 1166, 1170 (9th Cir. 1992), such authority does  
16 not lie under § 1927. F.T.C. v. Alaska Land Leasing, Inc., 799 F.2d 507, 510 (9th Cir. 1986).  
17 Galasso, on the other hand, is an attorney and has participated as an attorney at various stages  
18 of the relevant proceedings. As owner and managing partner of Verve, as well as head of the  
19 intellectual property practice at the SGF Firm, he was directly involved in unreasonably and  
20 vexatiously multiplying the proceedings against Hypercom.

21 Galasso's only argument in opposition to Hypercom's motion for summary judgment  
22 is that § 1927 is intended to apply only to the case presently before the court and therefore  
23 cannot be used to impose upon him fees and costs incurred in the Michigan, ITC or  
24 California actions. Galasso cites no legal authority to support this contention and Hypercom  
25 does not respond. Although we have found no case directly addressing the issue, those  
26 courts finding § 1927 liability based on the filing of multiple lawsuits have imposed  
27 sanctions in the form of costs and attorneys' fees associated with the instant action only. See,  
28 e.g., Stone v. Baum, 409 F. Supp. 2d 1164, 1172 (D. Ariz. 2005); Pentagen Tech. Int'l Ltd.

1 v. United States, 172 F. Supp. 2d 464, 474 (S.D.N.Y. 2001). We follow this lead and  
2 conclude that sanctions against Galasso in the form of attorneys' fees and costs incurred in  
3 defending the Texas action are warranted.

#### 4 **VI. Motion to Withdraw**

5 Counter-defendants' lawyers filed a motion to withdraw as counsel citing a conflict  
6 among the counter-defendants (doc. 275). Substitute counsel entered appearances on behalf  
7 of Verve, Galasso and the SGF firm, but stated that they were not appearing for Imes. We  
8 grant the motion to withdraw with respect to Verve, Galasso and the SGF firm because  
9 substitute counsel has confirmed, in accordance with LRCiv 83.3(b)(3), that they will be  
10 prepared for trial on October 12, 2006. We deny the motion with respect to Imes, however,  
11 because there is no indication that he can obtain substitute counsel or will otherwise be  
12 prepared for trial. Under ER 1.16(c), Arizona Rules of Professional Conduct, a lawyer shall  
13 continue to represent a client, notwithstanding good cause for termination of the  
14 representation, upon order of the court. Here, we are too close to trial to permit withdrawal  
15 of counsel that will leave a party unrepresented. In any event, having ruled on the issues of  
16 liability, it is doubtful whether any conflict of interest remains in this case.

#### 17 **VII. Conclusion**

18 Based on the foregoing, **IT IS ORDERED GRANTING** Hypercom's motion for  
19 summary judgment on count I against all counter-defendants with respect to the Michigan  
20 and California actions, and **DENYING** the motion as to the Texas and ITC actions (doc.  
21 243).

22 **IT IS FURTHER ORDERED GRANTING** Hypercom's motion for summary  
23 judgment on count II against all counter-defendants as to the Texas, Michigan and California  
24 actions and **DENYING** the motion as to the ITC action (doc. 243).

25 **IT IS FURTHER ORDERED GRANTING** Hypercom's motion for summary  
26 judgment on Count III against Galasso only and **DENYING** the motion as to Imes and the  
27 SGF firm (doc. 243).

